RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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May 1 DJIA 2280.39; PTI 2568; A-D Ratio -6.07

THE PICTURE: Question: Is it possible that we are now in a bear market?

Answer: There's not a man, woman, or organization on the face of the earth that can provide an authoritative answer to that question at this time. But as I've warned in Letter after Letter, we have been in the phase of this bull market (i.e., the third phase) where bear markets start. I won't go over all the numbers again (they appeared in the last Letter and in preceding Letters), but the market advance since 1984 has been a record breaker in terms of extent, a record breaker in terms of overvaluation of stocks, and a near-record breaker in terms of duration.

Furthermore, we have been listening to a chorus of analysts and "experts" who have insisted at every turn that "this is a mere correction in an ongoing bull market." Frankly, I can't remember when I have seen such persistent and stalwart confidence in the market. I guess I'm reminded of the old adage which goes, "When everyone thinks the same, nobody is thinking at all."

My own opinion has been that this is the time to be very cautious. Furthermore, I have stated that this has been a time to be taking profits. As far as the popular and widely-held prediction that "the Dow will hit 3000 or 3500" some time later this year, my response is, "I sincerely hope so, but I wouldn't want to bet on it." At Dow 3000 the yield on the Industrial Average would have to go down below 2.7%, a rarefied level which has never been seen before. So why, I ask myself, why bet on "a financial first" this time? Is 1987 a better and more bullish year than any other in stock market history?

Question: What would signal a bear market?

Answer: Very simple: First, the Averages (Industrials and Transports) would have to sink into a FULL secondary reaction (which I believe they've already done). Next, the Averages would have to rally, but on the recovery ONE or BOTH Averages would have to FAIL to better the old highs -- the old highs being 2405.54 for Industrials, 961.48 for Transports. The two Averages would then have to turn down and break below whatever lows are established during this reaction. If, on the second decline, the lows on BOTH the Industrials and Transports are broken (preferably on rising volume), a primary bear market will have been signaled.

Question: Russell, we've seen some rough selling during April. I know we have not received a Dow Theory bear signal, but how would you assess the damage so far?

Answer: The market and the major Averages have been "in gear" on the downside, at least until the April 27 lows. At that point the market seemed temporarily over-sold, and a rally was underway (on the rally, the Transports seemed to be lagging almost from the beginning).

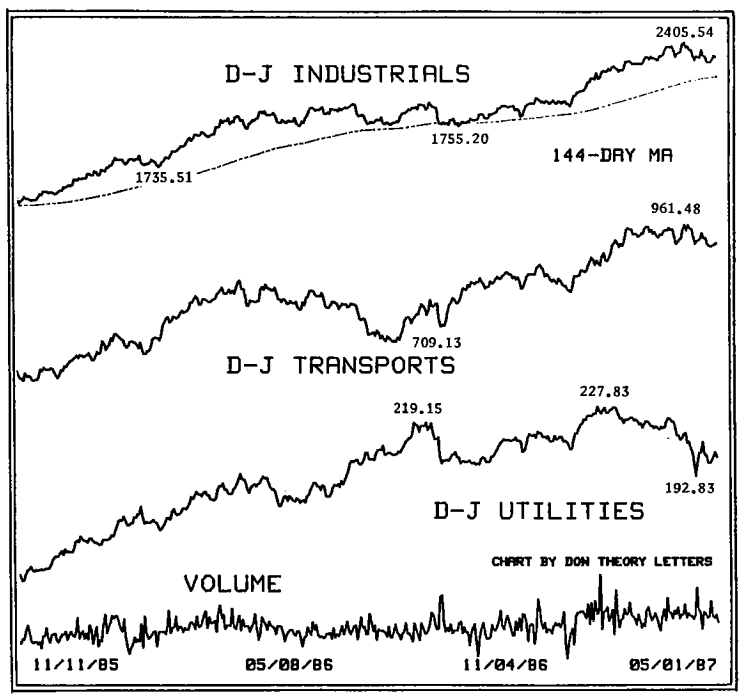
Perhaps the easiest way to gauge the decline was in terms of the advance-decline ratio. The A-D ratio is a proxy for the entire market (see the page 2 chart), and on the decline the A-D ratio took a beating. On the rally from the December low to the March 23 high the A-D ratio gained 5.22 points. From the March 23 high to the April 27 low the A-D ratio gave back 3.55 points or 68% of its December-March rise. The fact is that the March-April smash wiped out almost all of the 1987 gains, taking the A-D back to its level of January 7. In all it was a bearish performance, and frankly, I'd be surprised to see the A-D at new highs again.

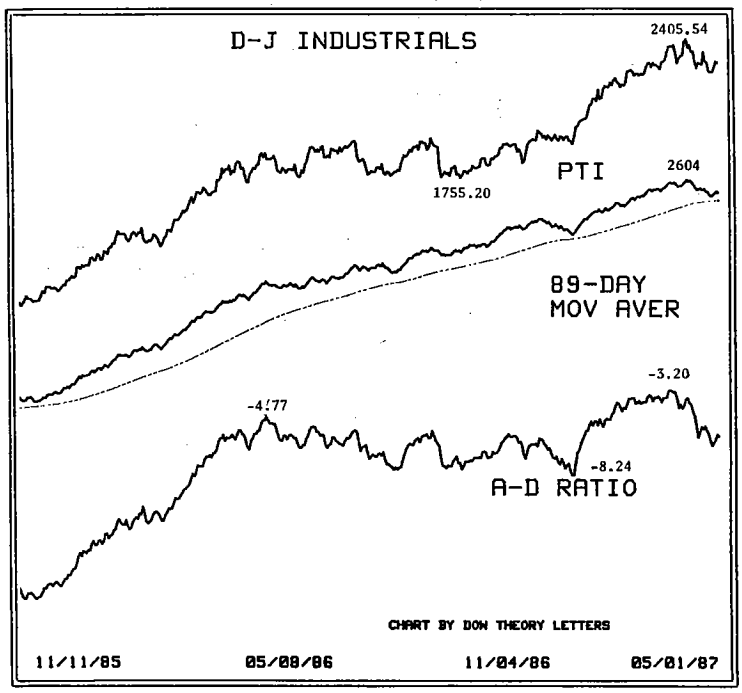
It might also be well to note that my PTI (see page 2 chart) formed a small head-and-shoulders top and then broke down. The PTI on April 27 fell within a few points of its 89-day moving average, then rallied. A decisive break below the moving average would constitute a major sell signal for the PTI. As I've written over the years, it's my policy always to stay on the right side of the PTI. If the 89-day MA is broken, the "right side" will be on the sidelines and pretty much out of common stocks.

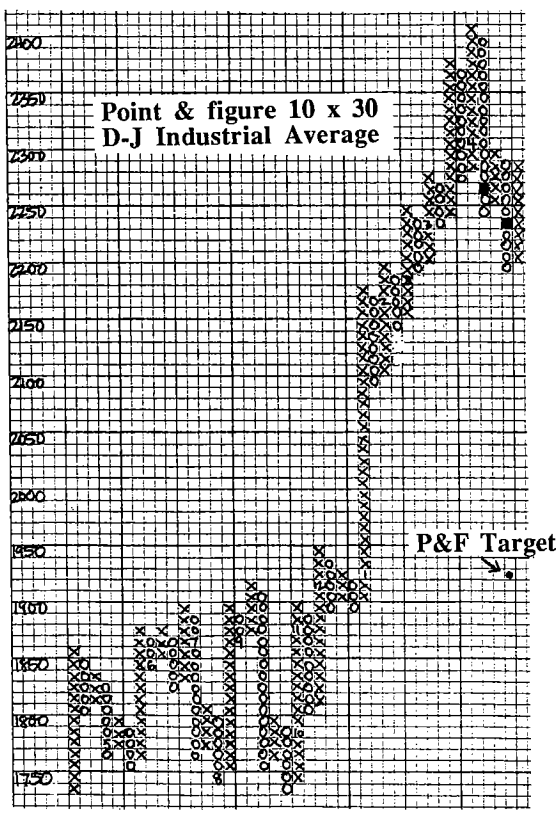
The point & figure chart of the Dow (see page 2 chart) is well worth studying here. Each box on the chart represents 10 Dow points and only rallies and declines of 30 or more points are depicted. One of the valuable features of P & F charting is that it provides "counts" or targets when bull or bear signals are rendered.

When the Dow dropped to the 2270 box (first solid black box on the chart), a sell signal was rendered. On a vertical count, that sell signal gives us a downside target of 1930 for the Dow. A second confirmatory sell signal was given (lower black box) when the Dow hit 2240, thereby breaking the preceding decline bottom.

If you remember, back in Letter 954 (with the Dow in the mid-1900s) I showed that the P & F count for the Dow gave us a minimum upside target of 2220. I mentioned at the time that the P & F count often overshoots its target when such counts are in the direction of the primary trend. And that is just what happened as the Dow overshot the 2220 target and rose to a peak of 2405 on April 6.

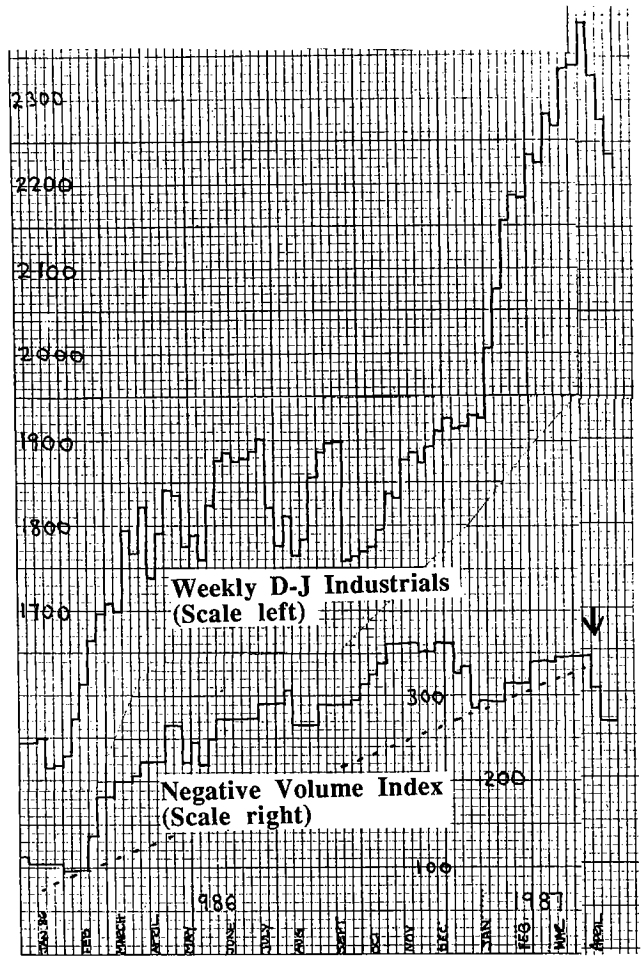






I now have a downside P & F count of 1930 for the Dow. Whether the Dow makes it down to the 1930 area remains to be seen. If, and I say IF, this turns out to be a primary bear market, I would expect the 1930 level on the Dow to be far surpassed on the downside. If, on the other hand, this is a mere corrrection, then I would expect the Dow to halt its decline well above the 1930 level.

The next item I want to discuss is the negative volume index, an index which for some reason only Market Logic and Dow Theory Letters monitor. This index tracks the weekly advance-decline differential on the NYSE -- but ONLY on weeks in which volume is below that of the preceding week. The theory behind this is that informed money tends to operate during market periods of comparative calm (low volume weeks), while the public tends to



operate during periods of general excitement (high volume weeks). Thus the negative volume index tracks the path of sophisticated and informed money, and, of course, these are the people who make the long-term trend of the market.

The chart on page 2 shows the Dow and the negative volume index (NVI). Note that on the week ending April 10, the NVI broke below its long-term rising trendline. This break represented a strong sell signal for the NVI and it represented a big plus for the bears.

The excellent Market Logic advisory uses a 52-week moving average to track the NVI whereas I use long-term trendlines. Market Logic has just announced that by their moving average method, the NVI (following a 76-week rising trend) has finally turned bearish. Therefore both Market Logic and I agree on the trend of the NVI.

There is a normal tendency over the years for the NVI to decline. So any long-term bull trend in the NVI is both unusual and significant. In a 35-year study of the NVI, Market Logic discovered that when the NVI is in a bullish mode, there is a 96% probability that the primary trend of the market is bullish. Conversely, when the NVI is in a bearish trend (as now), there is a better than even (53%) probability that the primary trend of the stock market is bearish.

Thus, the NVI study is saying (1) that the bull's case is no longer being bolstered by a rising NVI, and (2) that there is now a better than even chance (a 53% probability) that the primary trend of the market is now down.

Question: Russell, I know you've discussed this before, but what are your latest thoughts on the Utility Average?

Answer: The Utility Average topped out on January 22 at 227.83. The Utility Average plays no part in Dow Theory, but as veteran subscribers know, I follow the Utilities with interest. The utilities tend to be highly leveraged stocks, and they depend on the money

markets for much of their frequent financing. Thus the Utilities are particularly sensitive to present and forthcoming interest rates. The Utilities are also a good indicator of energy consumption.

We now know that at least one item the Utilities have been discounting is the rise in interest rates which has occurred over the past few weeks. Another item the Utilities could be reflecting is the topping out of the stock market in general, since the Utilities, on a number of occasions in the past, have turned down anywhere from a few months to a year or so ahead of the general market.

One interesting observation: The Utility Averages, after topping out at 227.83 on January 22, sank to a low of 192.83 on April 14. But note on the page 1 chart that the 192.83 low HELD on the Utility Average despite the fact that the Averages continued down. My feeling is that this early low in the Utility Average was signaling (1) a coming low in the bond market, and (2) a coming low in the rest of the market. If so, it will be most important to see how the market acts on the rally.

Question: Russell, what do you make of the dismal action of the bond market?

Answer: To put it mildly, the bond market acted during March and April as if it has been pole-axed. I have all along recommended the purchase of bonds rated only AA-rated or better. Furthermore, it is well to realize that high-grade bonds have one great advantage over stocks, particularly during a bear market. The advantage is that the bonds represent debt, and debt must be serviced (via interest payments) or the company that issued the debt goes into default.

So when the markets cave in (1) the bond-holder knows that he will receive his payments, and (2) and this is very important, the bond-holder knows that he will be paid off at par (which is $1,000) when his bonds mature.

Unlike the bond-holder, the stock-holder (during a bear market) worries (1) that his stock's dividend may be cut, (2) that the company may face severe adversity in which case even lower interest rates won't help the price of his company's stock, and (3) that in a severe bear market (this is the ultimate terror) his company could go bankrupt.

COMMENTS: As older readers know, I am not a big believer in market cycles. Or let me put it another way -- I believe that cycles may exist, but I am not convinced that anyone is smart enough to identify them. I'll go a step further -- if there is anyone who can identify cycles in a useful way, it's got to be Peter Eliades, a real student if there ever was one (2250 Cahuenga Blvd, LA, CA 90068). Peter's latest report offers a most interesting test for cycle followers.

Peter notes that over the last 25 years the Dow has closed under 600 twice, once in June '62 at 535 and again in December '74 at 570. There were 650 weeks between those two major bottoms. Going BACK 650 weeks from June '62 takes the market to January 9, 1950, at which time the Dow closed at 201.98. Over the next four days the Dow declined 2.5%, but the Dow has never been lower. Now, going FORWARD exactly 650 weeks from the December 9, 1974 low takes us to May 25, 1987. If the 65-week cycle works, the week of May 25 could represent another major bottom.

The Russell opinion: I'm open-minded and flexible but alas still skeptical. I believe that the primary trend is by far the most important phenomenon in the market. If the primary trend turned down last month on April 6 then this market is heading into the tank, and it's only a matter of time. But if the bull still lives, then in due time we'll see new highs.

INVESTMENT POSITION: In the absence of a bear signal, the bull stays in the box. The bull is still minus one horn — which is my way of saying that half is power has dissipated.

Tactics: I've been advising a continuing policy of profit-taking -- or (gulp) if you have losses, loss-taking. Our longer-term aim is to be completely liquid somewhere near the top of this bull market. With the Dow yield now in the 3% area, it is instructive to know that only once in history has a 3% Dow yield been followed by substantially higher prices (thanks to Investment Quality Trends of La Jolla for this item). That was in 1964 when the Dow yield hit 3%. The Dow rose another 15% into 1966, but because of rising dividends the Dow yield in 1966 was still 3%. (Note: The current period is NOT a period of rapidly rising dividends.)

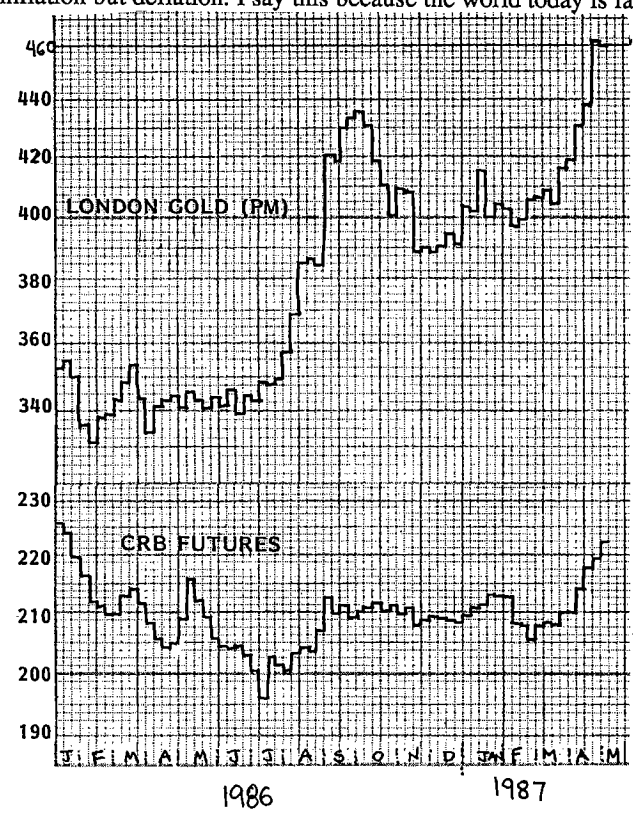
At this point I'm reminded of the old adage which goes, "If you want to be rich find out what the poor people are doing -- and then do the OPPOSITE." OK, what are the poor people doing today? From what I can see they're buying their heads off, running up debts, and saving damn near nothing. So the opposite would be to build up cash and cash-flow, and that's what I'm advocating.

People ask me what stocks to sell in order to build up cash. My answer is, "What stocks do you own?" Then they reply, "But what if the Dow goes to 3500 next year, and I'm 80% in cash?" I answer: "In that case you'll just have to tell your grandchildren that in the great bull market of the 1980s, you got out a bit too soon."

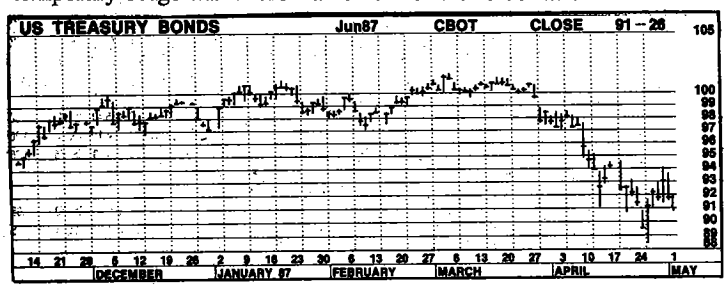
BONDS, RATES, INFLATION: Call me crazy, but I don't think we are dealing with inflation today. I believe gold is in a bull market, but I don't think the gold bull market is based on inflation. I do think the gold bull market is based on investors' fears for the dollar. To me, the amazing thing is that in the face of the massive dollar collapse, the rise in the dollar price of gold has been so modest.

I am including here a ratio chart of gold and the CRB Commodities Futures Index. As you can see, the trend of the Index has been up since last July, but with it all the CRB Index has not yet bettered its early-1986 high.

Actually, the way I see it, the major threat to the world is not inflation but deflation. I say this because the world today is facing



two gluts -- a glut of supplies ("things") and a glut of debt. Both of these are basically deflationary in nature. True, with the collapse of the dollar we are now seeing the price of imported items rise, and this accounts for the touch of "inflation" which we are now experiencing. But I don't have any feeling that the recent price increases represent the beginning of real inflation. I call them a temporary bulge within the framework of world deflation.



I show the chart of the Treasury bond futures here, and you can see the obvious breakdown. The breakdown is a direct reflection again of the collapse in the dollar and the fear that the falling dollar will cause the Japanese to halt their buying of US debt. Whether the Japanese will actually cut down or halt their buying of US bonds remains to be seen.

At this point everyone and his brother is bearish on bonds. Me, I'm neutral. I was interested, however, in "Industry Forecast's" comments (Levy Economics, Box 26, Chappaqua, NY 10514) regarding the economic picture and rates. Here they are: "*Inflation will be 3% or less this year, and interest rates will resume their downward path. The long-term decline in interest rates, although sharply interrupted, is not over. ... The spurt in long-term bond yields reflects misguided fears and expectations. The higher interest rates will initially increase the downward pressure on the economy and on inflation, and ultimately, on interest rates themselves.*"

THE TRIP: We're back after three days in New Orleans and six in New York City. What can I say about New Orleans? -- hot! We hit record breaking heat for April -- into the 90s. Had lunch with Jim Blanchard of seminar fame and found him in good shape and on an amazing diet. He drinks juices for breakfast, a baked potato for lunch and maybe vegetables and another potato for dinner. He does that five days a week. But on the weekends he eats and drinks anything he wants. The diet works. He looks lean. I've got to try it. ... New Orleans must be the "trade it in" center of the world. Walk down Royale Street, and you'll see the graveyard of all the antique and second-hand jewelry ever sold -- plus old guns, arrowheads, furniture, paintings, civil war memorabilia, etc. It's amazing. New Orleans is also the nation's "eatingest town." Restaurants everywhere, while joggers, bicyclers and aerobics studios are almost non-existent.

With the oil slump, Louisiana, a big oil producing state, is now in severe recession. Unemployment in LA is 14.3%, highest in the nation. The state is running fat deficits, and is borrowing to stay afloat. In February Moody's downgraded the state's GO bonds from A to Baa1, which makes financing much more expensive. Homes in Louisiana have come way down in price, and it's bargain living in bayou country.

New York: it's more crowded than ever -- wall to wall people with no two appearing to speak the same language! And the garbage is still piling up. Every side street boasts its own orange peels and hamburger buns in the gutter along with mountains of black plastic bags full of gad knows what. But New York is also an eater's paradise with four or five restaurants lining every block. We wondered why builders even bother to put kitchens in the apartments. In Manhattan midtown, it's new buildings everywhere. If the trend continues, Donald Trump will have rebuilt most of the City and the Japanese will own most of it. Oh yes, the other phenomenon. The Koreans have completely taken over the small grocery business. Every block has a Korean greengrocer who sells fruit, vegetables, bread and even flowers. And these guys stay open 24 hours a day. They work while the rest of NY sleeps!

We had a fine meal at NYC's only five star restaurant, Lutece. Also a good meal at Harry Cipriani, the City's most crowded and "in" restaurant. Shocker: As a lad, I used to buy "expensive" sodas for 40 cents at Rumpelmayer's, a landmark ice creamery on Central Park South. We passed Rump's and I stopped to check the price of a soda. The current price is $4.50. I still haven't recovered from that one.

We attended Jim Grant's annual interest rate conference at the St. Regis Hotel. Featured speaker was Ed Hyman of C.J. Lawrence. Ed stated that the stock market is now presenting all the elements of the greatest top he had ever seen. But then, surprisingly, he opined that the market would go still higher. Ed may be right on this, but my own stance is "show me."

Faye and I did a LOT of walking in the City, and I guess nothing much has changed except that the population of NYC continues to rise. The shopping is still (by far) the best in the nation. If it can be bought at any price, it's for sale in Manhattan. Furthermore, it's probably on sale on the streets (the street vendors are everywhere pushing everything from watches to jewelry to hot dogs and knishes).

We visited the new Jacob Javits Convention Center, and the place is a mind-blower. It's all glass, constructed like a giant futuristic greenhouse -- fifteen stories high and four blocks long (they told us the Empire State Building could be laid on its side in the Center without touching the walls!). At the Center was the Greater NY Int. Car Show which included all the new domestic and foreign cars. Sadly for the US, we felt that 90% of the excitement was in the foreign cars. However, one domestic winner was the beautiful new Buick two-door coupe, which will be out in early '88. It's the best looking US car I've seen in a decade.

Faye and I both felt that the city was in a buying frenzy. The stores were full, bursting with buyers. The new mini skirts are appearing. And NYC women are now wearing their hair longer. I'll let you guys in on an unbiased secret. The best-dressed women in the world live in NYC. But the best-looking women in the world live in Southern California. I defy anyone to visit a San Diego beach and argue with me on that one.

PHILOSOPHY: Do people get what they deserve in this life? I've often pondered this question, and I honestly don't know the answer. Did the children of the Holocaust get what they deserved? Only a monster could think they did. I've thought long and hard about that one. I've thought about it for years.

From a spiritual standpoint, one can say that the powers above will sacrifice one or 10,000 or 10 million people to make a point, to make a point great enough to change man's consciousness so that civilization can be advanced. And maybe that's what happened in the Holocaust.

Or if you believe in karma and reincarnation you might say that the victims of the Holocaust might have been paying for past crimes, crimes so hideous that only through the horror of the Holocaust could their karma be wiped clean. It seems unbelievable and heartless to think this way, but I can't make sense out of it any other way (assuming the Holocaust made sense at all).

Personally, I believe in karma. And I don't believe that anyone gets or wins or inherits anything they don't deserve. I've always operated on the premise that we get what we NEED on this earth, not what we want. Why do we get what we need? I believe we get what we need so that we can advance as individuals. I firmly believe that the powers above intend man to ADVANCE spiritually and psychically, and the means to man's advancement are therefore placed in front of him.

So man exercises his free will. It is our job to choose. We choose the paths we take. We choose honesty or the lie. We choose the profession we will follow. We choose the place we live in. We

choose our mate. We choose to eat this meat or no meat or this vegetable or that fruit. We choose to smoke or not to smoke. We choose to have children, and we choose what school to send those children to.

All right, how does all this apply to investing? I believe that each of us must choose the type of investing he is best able to operate in. I may like to invest in bonds, I may not have the temperament to deal with stocks. You may like to sell puts and calls, while your neighbor may feel comfortable buying gold.

I'll go further. I believe that the market only gives us what we need and what we deserve. I know that sounds a bit crazy, but I've watched investors for many years, and I've seen some that can't make a nickel no matter what the market does and no matter who they follow. And I've seen others that consistently do well in their investing, and they do well seemingly without strain or pain.

Furthermore, I've seen a few people who did very badly at first, and then I've seen them change, I've seen them learn, and finally I've seen them make money and keep that money. And in every case I've said to myself, "That fellow deserves to profit this time. He's earned that money. He's paid his dues, and this time he's earned every cent that he's taken out of the market."

All right, I've rambled on for a while, but what am I really trying to say in this piece? I think it's this. Don't try to do things in investing or speculating that are beyond your scope. Don't press yourself to do the impossible. How will you know that you're doing things in the markets that you should not do? Believe me, the market will tell you very fast -- in terms of LOSSES. Yes, the market will tell you so fast that your head will spin!

I'll give you an example. My wife, Faye, is a much better speculator than I am. For some reason, not clear to me, I was never meant to beat the market via speculation. I can do very well in long-term investing, but I was never meant to beat the market in commodities, shorts, options, puts, or calls. They just aren't for me, and I know it, and I don't enter these areas any more.

Faye has the makings of a good, even an excellent speculator. I don't know if she has different or better karma than I do, I don't know how or why, but I know that Faye has what it takes to make money in intelligent speculation. It could well be that she "deserves" those kind of profits or that she in some way "needs" speculative profits. It's obvious that I don't. I have always made my living by writing about the market or investing in a long-term sense.

I guess that's all I have to say on this subject. I'm still pondering it, and I am still amazed at the way one man will do well speculating in the market while another (who is just as intelligent or even more so) loses his shirt every time.

But the important thing is to experience which of these two fellows you are. And it's also important (I think) not to blame yourself if you're not able to make a speculative buck. As the old saying goes, "Nothing is given to man." No, you have to earn it or have it coming to you. Or in some strange way, you have to need it. And finally, I don't think that it's we, ourselves, who determine what we need.

NOTES & QUOTES: From our "Shock of the Month" Dept: There are now 1,846 mutual funds, which is MORE than all the companies (1,584) listed on the NYSE. What does that statistic mean? To me, it means that selling funds to the public has become the biggest and most profitable game in town. How will it all end up? My guess is that it's going to end in disillusionment, with the relative strength of the funds falling below the general market's strength. In the next bear market, I think the selling of funds is going to result in severe illiquidity. With instant or overnight redemptions and switching, who will be buying all the stock that will be offered for sale by the funds? Nah, don't tell me it will be the Japanese. Maybe the South Koreans ... ?

* *

Speaking of funds, many investors are now excited about foreign markets, and it's become a case of "What country do you like this month?" The capitalizations of many foreign markets are very small, and therefore a limited amount of incoming money can drive these markets through the roof. For instance, the total capitalization of Denmark's stock market is only $11 billion, Hong Kong $63 billion, S. Africa $35 billion, Spain $47 billion, Sweden $49 billion, S. Korea $13 billion. In contrast, the US market is capitalized at $2.203 trillion! So when money roars in and out of these smaller markets, it's a case of zoom or crash. Funds covering single countries exist for Australia, France, Germany, Italy, Japan, Netherlands, S. Africa, and Sweden. Conclusion: Be careful when investing in foreign markets, many of which are illiquid.

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Faye and I are both addicted want-ad readers. Last week in NYC we pulled these ads out of the New York Times. Actually, I thought the Japanese ran out of money when they bought the Van Gogh sunflower picture for $39 million but no, they're still at it, as are the Swiss.

Wanted **9006**

JAPANESE INVESTMENT GROUP

Seeking to buy for immediate CASH French & American impressionist and post impressionist paintings. All inquiries held in strictest confidence. Please reply with photos, prices, and all other information to: ART, 441 W 50 St, NY, NY 10019

SWISS INVESTORS BUYING

Leger, Utrillo, Luce, Lebasque, Guillaumin, Loiseau, D'Espagnat, Metzinger, Hayden, Marcoussis, Edzard, Cortes, Mane-Katz, Chagall & other Europeans; also fine prints by major artists. Call 212-431-6025.

* *

Guns: My own idea of helpless, stupid horror is to be caught in my own house by some homicidal doper or criminal, caught with no way of defending myself. So I keep guns in the house, a shotgun in the bedroom and three 45s hidden in various places. Maybe I'm crazy, maybe I'm just a product of WW II, maybe a lot of things, but I don't believe in a passive death at the hands of another. And these days, there are a lot of "anothers" prowling around.

The National Rifle Assoc. puts out a monthly magazine entitled "American Rifleman." It's a gunny's magazine, but it's informative (if you happen to be interested in guns). The AR believes in home defense, and in each issue there is a page called "The Armed Citizen." The column gives numerous examples of citizens and their experiences with intruders. Here are a few examples from the latest issue:

A Bridgeport, Conn., resident went to help two men who said their car had broken down near his home. But when his wife saw the pair strike her husband with a hammer, she came out of the house firing a .38. She struck one of the assailants, and two suspects were arrested at a local hospital where the injured man sought medical treatment. (*The Evening Post*, Bridgeport, Conn. 3/9)

At a Cleveland, Ohio, doughnut shop a knife-wielding robber ordered two female clerks to lie on the floor. When he ordered Bonnie Kerkhoff to hand over her purse, she complied but produced a .38 revolver from it and fired at the intruder, wounding him. Police charged a wounded suspect with aggravated robbery. (*The Plain Dealer*, Cleveland, Ohio 3/7)

* *

Biggest exporter of American manufactured goods? It's the US aerospace industry, which recorded a $13 billion trade surplus in '85. But it's getting a lot tougher for US manufacturers. The competitors are ganging up. In the past six months Airbus Industries (a consortium of French, German, British, and Spanish firms) has landed major orders of roughly $7 billion from US airlines -- amid American cries of unfair foreign government subsidies.

* *

Numbers: A seat on the NYSE sold last week for a record $1.1 million. I remember back in the 1940s when a friend of mine bought a seat for $70,000 and I thought that was high. ... Last week a seat on the Chicago Mercantile Exchange sold for a record $149,000. During the same week a full membership on the Chicago Board of Trade (biggest marketer of T-bonds and T-bond options)

sold for a record $470,000. The buyer was said to be Nomoura Securities International of Tokyo.

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More numbers: Kitty Kelley's book about Sinatra ("His Way") has sold an astounding 1,579,300 copies in hardcover. Kelly was paid $1.5 million in advance for the book and will probably make as much in further royalties.

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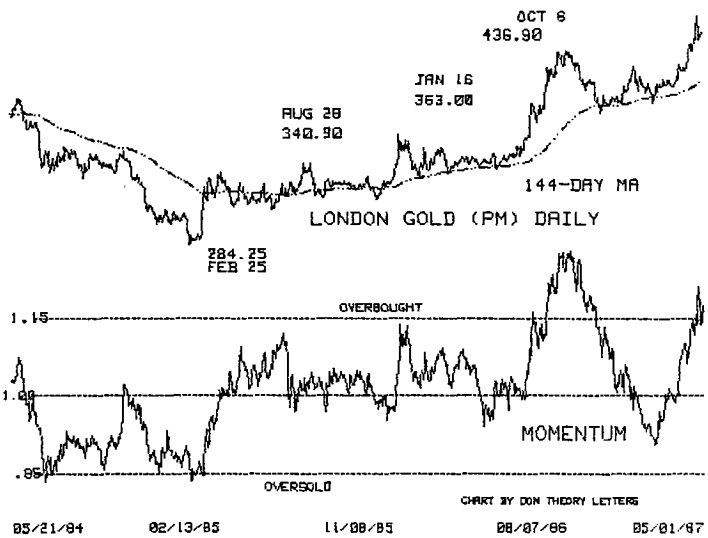
Last paradise: Is there a bargain paradise left in the world? Yes, according to my friend Auggie Nguyen (cashier) at Hutton's La Jolla office. Auggie's wife works for Pan Am so the two of them can see the world at almost zero bucks a ride. Auggie is just back from Uruguay, and here's what he says: "It's paradise, great scenery, lush surroundings, no beggars in the streets. Montevideo is much like Lucerne: clean, good shopping, outstandingly pretty. Punta del Este on the coast of Uruguay is much like the Cote d'Azur in France -- beautiful, a true gem. Prices: $12.50 a night in first-class hotels, $2.50 for a fine dinner. It's like living back in the 1940s from a price standpoint. What's the catch? The trip is 23 hours from San Diego, it's one long ride "but worth it," swears Auggie.

GOLD: The gold shares have exploded on the upside (see chart of the XAU gold/silver average on page 4 of the last Letter). Since last July the XAU has advanced 147%, and it should come as no shock that the precious metals stocks are now correcting.

The charts below provide a good picture of where gold (the metal) is now. The current gold bull move began on February 25, 1985 at a London fix of 284.25. Gold is now up 62% from its '85 low. Note how the metal has been climbing up its long-term or 144-day moving average. The 144-day MA now stands at 411, so on this basis gold has gotten a bit ahead of itself. In other words, the metal could react down to the 415 level of the moving average and still look highly bullish.

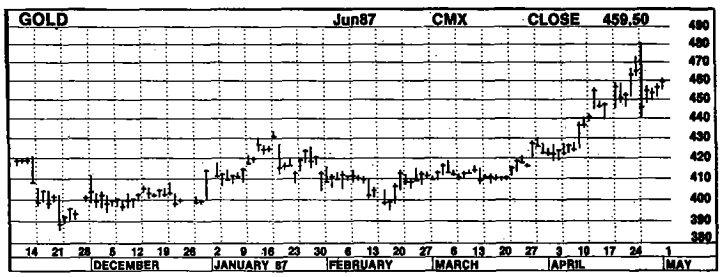


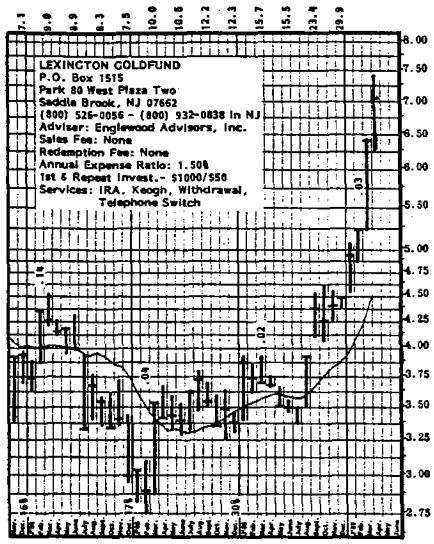
Gold "momentum" (see chart) provides another technical view of the metal. Last October gold's momentum (which is actually an 89-day rate of change) pushed far above the 1.15 over-bought area. This exuberance was followed by a few months of correction. Now again gold's momentum has advanced above 1.15, and now again gold is correcting.

At this time probably the easiest way to follow gold is via the June gold (commodity) contract. Gold is currently locked into the 440-480 trading range. A break below 440 on the June contract would probably mean a test of the 144-day moving average at around 412-415. On the other hand, a breakout above 480 would imply a rapid test of the 500 level.

I note that a few gold skeptics are saying that with all the new mines coming on stream, gold production will be up more than 25% over the last six years. Therefore, argue the skeptics, the world may soon face a glut of gold. But have these same characters measured the increase in paper money over the same period? Talk about a glut!

To those of you who are buying the gold coins on a dollar averaging program (as I have suggested you do), it makes little difference what gold does from here. We're in a gold bull market, and the point is that we want to accumulate the metal in the form of krugerrands, coronas, maple leafs, eagles. For those wanting the metal shares, I have recommended an easy way -- buy the Lexington Goldfund (chart courtesy of Growth Fund Guide, Box 6600, Rapid City, SD 57709).





LATE NOTES: Suddenly, everything is questions, and the questions all hinge around the dollar. Will the dollar (in the face of huge US balance-of-payment deficits) continue to slide? If the dollar continues to slide, will the Japanese buy our debt? If the Japanese don't buy our debt, won't the bond market swoon? If the bond market swoons, interest rates will obviously go up, and if rates go up, won't the stock market top out and won't the US economy sink into recession? It's hardly a pleasant scenario.

But readers of Dow Theory Letters don't try to figure out the markets from the fundamentals, we let the markets tell us the story. So from a hopeful standpoint, the bonds look like they could have formed a bottom (see chart). The D-J Utility Average (which is extremely sensitive to forthcoming interest rates) hit a low (well ahead of the rest of the market) on April 19 at 192.83, and the Utilities haven't been lower since (see page 1 chart). And remember, the Utilites have tended to top out and bottom out AHEAD of the rest of the market. Could the Utility and Bond Averages have already discounted the worst? Yes, they could have. Furthermore, the D-J Industrials and Transports, having declined for almost a month, appear to be groping for a bottom. Finally, my PTI is still holding above its 89-day moving average.

Critical points to watch -- watch the April 27 low of 2230.54 on the D-J Industrial Avaerage. Watch the April 19 D-J Utility low of 192.83. Watch the T-bond low (June contract) of 88. And hope one or preferably all three hold. If they don't, Wall Street is going to look even messier in May than it did in April.

NEXT MAILING: May 20